

Self Directed IRA

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What the heck is a self directed IRA? Just because you make investment choices within your retirement accounts, does not mean they are self-directed. Sure, in a practical sense they are. But a self-directed IRA in the context of this section is about a very specific investment vehicle where you control the investments beyond the garden variety mutual funds, stock, bonds, ETFs, etc.

The predominant use of a self-directed IRA is rental property acquisitions since it offers great elegance and excellent returns on investment.

Self Directed IRA Real Estate

Why would you consider this option? Let's assume that you want to invest into rental properties (which is a great augmenting retirement strategy by the way.. we are huge fans), but all your money is tied up in an IRA. You are 50 years old, and can't touch it without penalty. The bank won't let you borrow against it. You might be hosed.

However, if you set up a self-directed IRA and roll your existing IRA into it, you can have the IRA invest into the rental property. But there is another reason why this might make sense. The S&P 500 index for the past 20 years has returned 9.22%. Not bad. Yet in some situations, rental properties might beat or in some cases, crush, the returns of the stock market. And it creates some diversification within your financial planning along with long-term income generation.

The self directed IRA real estate transaction must be arms length. For example, you cannot have an IRA purchase a ski condo in Florida that you rent out, and use occasionally yourself. Not because they don't have ski condos in Florida rather this is considered self-dealing. There also disqualified persons such as your spouse, parents, children and their spouses, etc. who are not allowed to be associated with the investment or transaction.

Self Directed IRA for Business

The other option with a self-directed IRA is to start or purchase a new business. A new business might need cash to invest into equipment, franchise fee, marketing, operational cash, etc.

If you want to expand your horizons into real estate notes, equipment leasing, livestock, private debt and equity placements, and oil and gas you can also use a self-directed IRA. Be careful here. Suitability might be your biggest hurdle, but unfortunately we are all humans and can pretty much talk ourselves into anything. Talk to your financial team before squandering your life savings on ocean front property in Arizona.

And a self directed 401k may be used as well. A 401k differs slightly from an IRA since it tied to your business. So you get the high contribution limits and no income phase outs of a 401k, and the ability to act as fund manager and purchase assets directly for the benefit of the 401k. This is complicated and requires extensive trust work, but not impossible.

Another option is a self directed IRA LLC where you have what is called "checkbook" control. This allows you to take your IRA, fund an LLC with the IRA as the owner, and you direct the LLC to make investments. There are some major pitfalls with this approach such as unrelated business taxable income and unrelated debt financing income not to mention the huge possibility of prohibited transactions.

The Employee Retirement Income Security Act (ERISA) has made strides in how self directed IRAs are to be implemented, but the IRS which has jurisdiction over IRAs in general and the Department of Labor which has jurisdiction over prohibited transactions have been slow to adopt new policies. In the past IRAs were mainly institutional and in some cases self-governed. In other words, it was easier to have oversight with 100 IRA providers rather than 10,000 self-directed IRA providers.

See the link below for the all kinds of problems associated with LLCs and self-directed IRAs-